EASTERN WASHINGTON BANKRUPTCY NOTES

PUBLISHED FOR MEMBERS OF THE BANKRUPTCY BAR ASSOCIATION • EASTERN DISTRICT OF WASHINGTON

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From the President

It has truly been a pleasurable experience being the President of the Bankruptcy Bar Association since June, 1996. This year at Sun Mountain, I will turn over the reins to the new President. This will probably be the last issue of Notes prior to Sun Mountain. Therefore, I would like to take this opportunity to thank all members for their continued support of the Bankruptcy Bar Association for the Eastern District of Washington. With your help, we have become a larger, more active organization.

As you are no doubt aware, we have sponsored the annual retreat and seminar at Sun Mountain for years. The event at Sun Mountain has grown into the best bankruptcy seminar/retreat in the Northwest. As those of you who have attended know, Sun Mountain is an exquisite setting with a variety of family and outdoor activities.

The Bankruptcy Bar Association has also begun to sponsor other seminars with the help and support of the Clerk's office and the Bench. With the help of Mary Jo Heston, we have been able to attract national caliber speakers to all seminars we've sponsored in the last couple of years.

The seminars we sponsored in the fall in the Tri-Cities and Spokane were virtually sold out. We've consciously tried to keep the cost of seminars low to encourage participation of the occasional bankruptcy practitioner and to provide useful information on issues that a wide variety of practitioners encounter in their day to day practice. We think, based upon the attendance and the positive reviews we've received, that we have been able to do so.

We are in the process of instituting a pro bono program. Many of you have already volunteered to be assigned pro bono cases which will be assigned from the Clerk's office and the Bench. The program will include referrals from existing pro bono programs being operated by local bar associations in Eastern Washington. Part of our seminar at Sun Mountain this year will be devoted to pro bono legal services.

You will soon be receiving an announcement and registration form for Sun Mountain. I encourage you to attend, especially if you have not attended before. The pleasures of the North Cascades and the quality, practical seminar is more than worth the price of admission.

In any organization there is always a core group of people who work hard to ensure the success of the organization. The "backbone" of this organization, as most of you are aware, is Ian Ledlin. He volunteers countless hours. He has a seemingly inexhaustible supply of energy which he applies to ensure success of any program that we undertake.

I would like to thank all of the board members for their active participation in the Bankruptcy Bar, especially Gary Farrell for taking on the unwanted task of being editor of the bankruptcy Notes. With the help and support of all the board members, we have accomplished a lot. It has been a pleasure working with you all to ensure the continued success and growth of this organization. It was a great two years.

Bill Hames

Attorney Sentenced

On December 2, 1997, James Graettinger, an attorney from East Wenatchee, Washington, pled guilty to the forgery of a federal bankruptcy judge's signature on a bogus court order. 18 U.S.C. §505. Mr. Graettinger presented the order to the Chelan County Sheriff's office in an attempt to obtain a horse from chapter 7 debtors. On February 11, 1998, Mr. Graettinger was sentenced to three years probation and full restitution. Mr. Graettinger also agreed to resign from the Washington State Bar Association, which he has done.

On April 14th, Mr. Graettinger contacted Judge Rossmeissl's chambers stating that he needed emergency relief. The debtors were leaving the state with his clients' horse, and he needed some sort of restraining order. He was advised that Judge Rossmeissl was in Portland for a conference, and that proper motions needed to be filed before the court could act. Mr. Graettinger contacted the attorney for the U.S. Trustee who also suggested that appropriate motions be filed before any action could be taken.

On April 15th, the Chelan County Sheriff's office contacted Judge Rossmeissl's chambers, stating that Mr. Graettinger was present with an order signed by Judge Rossmeissl directing the Sheriff to assist the creditors in obtaining possession of the horse from the debtors. Chambers personnel requested that the order be faxed for review, conscious of the fact that the attorney had not mentioned such an order in the previous day's conversations. The order was faxed to Judge Rossmeissl in Portland who verified that the signature indeed was not his. The matter was referred to the U.S. Attorney.

Inside...

From the Clerk

Fee Changes

The Judicial Conference of the United States Courts at its September 1997 session approved several changes to the Bankruptcy Court Miscellaneous Fee Schedule. These changes became effective on January 1, 1998. Several of the changes eliminated fees that were seldom incurred, such as the 50 cents notice fee and twenty-five cent claim processing fee. However, the following items in the Miscellaneous Fee Schedule are more frequently incurred and practitioners should be aware of the changes:

Item 2: The fee for exemplification of a document was increased from $5.00 to $10.00;

Item 9: Changed the time when a fee is payable from the actual order of reopening a closed case to when the motion is filed. The fee for filing a motion to reopen a case is the same amount as the filing fee. Thus a motion to reopen a chapter 7 or 13 case is $130, and for a chapter 11 case it is $800. No fee is required if the reopening is to correct administrative errors or for actions related to the debtor's discharge;

Item 21: The fee for filing a motion to terminate, annul, modify or condition the automatic stay, a motion to compel abandonment of property of the estate, or to withdraw the reference of a case under 28 U.S.C. 157(d) has been increased to be one-half of the filing fee for civil action under 28 U.S.C. 1914(a), which is $150. Therefore the fee to file any of these motions is $75. Combining a motion to lift the stay and to compel abandonment only requires one fee. It should also be noted that if a child support creditor or its representative is the movant or its representative and if such movant files the form required by Section 304(g) of the Bankruptcy Reform Act of 1994, no fee is required.

Changes To Official Forms

Effective March 1, 1998, several changes to certain Official Forms became effective. Generally the changes were designed to make the forms easier to read and to complete correctly.

Changes to the Petition Form reduced and simplified the amount of information required.

The signature lines now require the debtor to sign the form only once and the request for plan filing information has been deleted. Exhibit "A" has also been simplified. In addition, the category of Ch. 11 debtors required to file Exhibit "A" was modified to include a corporation, a partnership, or other entity, but only if the debtor has issued publicly-traded equity securities or debt instruments. Most small corporations will not be required to file Exhibit "A".

The Statement of Intention, required in Chapter 7 cases, was amended to conform more closely to the language of the Bankruptcy Code. The amendments also make clear that the form is not intended to take a position regarding whether the options stated on the form are the only choices available to the debtor. Compare Lowry Federal Credit Union v. West, 882 F.2d 1543 (10th Cir. 1989) with In Re Taylor, 3 F 3d 1512 (11th Cir. 1993).

Changes were also made to the Proof of Claim Form and to the forms of the Order of Discharge and Notice of First Meeting of Creditors which are designed to provide added and clearer information. Also, the forms are now double-sided.

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1998 Bankruptcy Seminar and Retreat

The Annual Bankruptcy Seminar and Retreat is scheduled for June 4 through 6, 1998 at Sun Mountain Lodge in Winthrop, Washington. This Seminar is sponsored by the Bankruptcy Bar Association of the Eastern District of Washington. It features nationally recognized speakers, topical information, and CLE credits in a relaxed resort atmosphere. Featured speakers at the 1998 Retreat are the Honorable Nancy C. Dreher and Professor Charles W. Mooney, Jr.

Professor Mooney teaches at the University of Pennsylvania School of Law. He is the Reporter for the Drafting Committee to Revise UCC Article 9. The work of this Committee is nearly complete. Substantial, significant revisions to Article 9 become effective at the beginning of the millennium. Professor Mooney will head a panel discussion of changes to come, and how they will differ from current UCC law.

Judge Dreher, from the U.S. Bankruptcy Court for the District of Minnesota, will discuss structured pro bono bankruptcy programs. This topic is of interest on both national and local levels. She will review techniques for designing and implementing pro bono bankruptcy programs that have been successful, and those that have not.

Some other seminar highlights include a discussion of agricultural liens by the Honorable Frank L. Kurtz; a panel discussion on dealing with tax liens in bankruptcy cases, and review of current case law developments. 8.5 hours of CLE credit, including an hour of ethics credit, will be applied for. Watch for registration information in April, 1998.

If you want to attend, you should reserve your room at Sun Mountain Lodge now. Call (800) 572-0493 to make your reservations. If you are not a member of the Bankruptcy Bar Association and want more information about the Seminar, call Ian Ledlin at 509/838-6055.

Bankruptcy Seminars Were Well Attended

If attendance is to be the measure of success, the October bankruptcy seminars held in Richland and Spokane were successful beyond expectation. Seventy-two attorneys and staff attended the October 29th session in Richland, Washington. One hundred and thirty-seven attended in Spokane on October 30th.

The board of directors of the bankruptcy bar for the Eastern District intentionally kept the price low; $20.00 for members, including lunch. The difference was made up from dues payments by the members. The board did so recognizing that one of the chief reasons for forming the organization was to provide opportunities for education of and sharing among its members. Other reasons for success were the Judge's panel and a national speaker, Judge Randall Newsome of Oakland, California. Judge Newsome was sponsored and his expenses paid by the Creditor-Debtor Section of the Washington State Bar Association.

Many thanks t the dozens of people who worked hard to make sure that the seminars happened. If you think that this type of seminar (or something similar) should be provided again, let your board members know. The seminar, by the way, was approved for 6.5 credits, with one of those credits being for ethics.

From the Clerk cont'd

Dollar Amounts Automatically Adjusted

The Bankruptcy Reform Act of 1994 provided for automatic adjustments of various dollar amounts contained in the Bankruptcy Code at three-year intervals, commencing April 1, 1998. Following is a synopsis of the changes that become effective on April 1, 1998. A copy of a memo from the Director of the Administrative Office of the United States Courts giving additional detail is available on the court's WEB site at www.waeb.uscourts.gov.

11 U.S.C. 109(e): debt limit for a Chapter 13 debtor increased from $250,000 unsecured and $750,000 secured debt to $269,250 and $807,750 respectively.

11 U.S.C. 303(b): minimum aggregate claims needed for the commencement of an involuntary bankruptcy up from $10,000 to $10,775.

11 U.S.C. 507(a): priority claims under sub-section (3) for wages and sales commissions up from $3,000 to $4,300; under subsection (4)(B)(i) for contributions to employee benefit plans up from $4,000 to $4,300; under subsection (5) for certain grain production employees, up from $4,000 to $4,300; under subsection (6) for money deposits for the purchase of goods or services up from $1,800 to $1,950.

11 U.S.C. 522(d): exemptions have also increased in the following subsections as follows:

(1) real property: $15,000 to $16,150

(2) motor vehicle: $2,400 to $2,575

(3) household goods: any one item $400 to $424, aggregate $8,000 to $8,625

(4) jewelry: $1,000 to $1,075

(5) any property: any one item $800 to $850, aggregate $7,500 to $8,075

(6) tools of the trade: $1,500 to $1,625

(8) 542(d) transfer: $8,000 to $8,625

(11)(D) personal injury: $15,000 to $16,150.

Debt incurred for luxury goods or services or for cash advances pursuant to 11 U.S.C. 523(a)(2)(C) up from $1,000 to $1,075.

Two of the Official Bankruptcy Forms, namely the Schedule of Creditors Holding Claims entitled to Priority, form 6E and Proof of Claim, form 10 will be amended to reflect the required changes.

Child Support Creditors

The Bankruptcy Reform Act of 1994 provided that child support creditors are exempt from certain miscellaneous fees so long as they file with the action the required form. The Form, entitled "Appearance by Child Support Creditor or Representative" (Form B 281) is available from the Office of the Clerk or is downloadable from the court's WEB site at www.waeb.uscourts.gov." The miscellaneous fees affected are for filing a complaint and motions to terminate, annul, modify or condition the automatic stay, abandonment or to withdraw the reference.

Orientation Seminar Planned

A no-cost orientation seminar is being offered by the Clerk's office in Spokane on May 7, 1998 and in Yakima on May 8, 1998. These orientation seminars are designed to familiarize secretaries, administrative assistants and paralegals who are either new to bankruptcy or to the Eastern District of Washington, with services offered by the Clerk's Office and with procedural requirements of the court. These seminars are considered to be very valuable and certainly enhance the effectiveness of an office in dealing with the Clerk's Office and participation is encouraged. Registration forms are available in person from the Office of the Clerk at either Spokane or Yakima, by telephone request at 509-353-2404, extension 200 or by FAX at 353-2404.

Applications to have Employment of Attorneys for Estates Approved

11 U.S.C. 327 provides authority for the trustee to employ professionals, including attorneys, to assist in carrying out his or her duties. However, such an employment requires court approval.

FRBP 2014 describes what information is required to be included in the application for approval of employment and LBR 2014-1 prescribes the use of a local form (LF 2104).

Once the professional so employed has performed service to the estate, then the professional is permitted to be compensated from the estate as a cost of administration pursuant to 11 U.S.C. 330. The rules related to this are FRBP 2016 and LBR 2016-1. LBR 2016-1 prescribes the use of a local form (LF 2016).

The application for approval of employment must state, among other items, any proposed arrangement for compensation. If the applicant desires that the order approving the employment is limited to that, and is not intended to also establish the actual rate of compensation, then notice to the Master Mailing List (MML), is not required. However, if the applicant wants also to establish the actual rate of compensation, then notice to the MML is required.

It is important to note that it is not the nature of the arrangement, be it on an hourly basis or a contingent basis that determines the extent of the order, rather it is the kind of notice that was given. The arrangement, although disclosed, is not approved unless there is an order specifically approving the arrangement after notice and hearing to the MML.

Notice & Hearing Tips

LBR 2002-1 addresses notice and hearing matters. Almost all actions are initiated with notice and hearing, and a thorough understanding and compliance with the requirements of this rule are critical to the efficient and timely processing of orders based on notice and hearing. Of particular importance is sub-section (b)(3) which requires that: "as soon as practicable, a party giving notice pursuant to this rule shall file as a separate document, an affidavit of mailing or unsworn declaration under penalty of perjury to which shall be attached a list containing the names and addresses to whom the notice was sent along with a copy of the notice." If this is done timely, when any order based on the notice is presented, the separate document described above will already have been imaged into the courts data base and the proposed order can be dealt with much more efficiently and promptly since retrieving the "paper" file will not be required. It should also be noted that there is no requirement that the notice be filed as a separate document; its inclusion as an attachment to the certificate of mailing is sufficient.

Numbers of Copies of Documents

LBR 5005-2 sets out the numbers of copies of petitions, schedules and statements of affairs that are required to be filed. Attention should be paid to the requirement of this rule so that the clerk and provide the copies to the proper parties. Failure to

From the Clerk cont'd

provide the requisite number of copies requires additional work on the part of the clerks office as well for the party involved, and normally results in some delay in the process.

Comments On Claims

In order for a party to participate in the distribution of funds of an estate it is required that a proof of claim be filed pursuant to 11 U.S.C. 501 and FRBP 3001, unless a claim is not required to be filed under FRBP 3003(b)(1). Claims are allowed pursuant to 11 U.S.C. 502. Distributions from the estate are made pursuant to 11 U.S.C. 726, 1226 and 1326. A proof of claim properly filed is deemed allowed, and constitutes prima facie evidence of the validity and amount of the claim. LBR 3007-1 requires that "an objection to the allowance of a claim shall include an affidavit or statement under penalty of perjury sufficient to overcome the prima facie effect of FRBP 3001(f)." Such a statement must contain sufficient substance to allow the court to make a finding sufficient to overcome the evidentiary effect of the proof of claim itself, a simple statement that amounts to little more than a bare objection is generally insufficient, even where the claimant raises no objection. Certainly a statement indicating that the prima facie effect of FRBP 3001(f) is not an issue is insufficient. Also a statement that a proof of claim was untimely filed is insufficient to support an objection to its allowance, since the timing of the filing of a proof of claim generally is a distribution issue and not an allowance issue. An untimely filed claim is not disallowed by that fact alone, but might not be paid until and unless timely filed claims are satisfied in full.

Additionally, the address given on the proof of claim is the proper address to which objections to the proof of claim should be mailed or served.

Bankruptcy Noticing Center

Notices sent by the Clerk's Office are electronically transmitted to the Bankruptcy Noticing Center (BNC) which is located in Reston, Virginia, and from there mailed to parties in interest. From the time that a notice is transmitted to the center, it takes the center approximately two days for processing, and 2 to 3 days mailing time. Thus parties should receive notices five days following transmission to the BNC. The standards established for processing various notices are as follows:

Notice of Meeting of Creditors: 5 days following filing of case
Notice of Discharge: 2 days following granting of
Notice of Conversion: 5 days following conversion

Web Site Established

The Court has established a WEB site, the address is www.waeb.uscourts.gov. The information presently available on the WEB site is general court information, the local rules and selected forms, both of which may be down loaded. Future additions to the WEB site are likely to include selected court opinions, specific case information, and frequently asked questions. Suggestions for information to be made available on the WEB site should be sent to the Clerk.

Filings Statistics

Filings in the Eastern District of Washington reached an all time high in 1997. Increase in filings in District have been moving dramatically upward since 1995, where an increase of 27.6% was recorded over 1994, in 1996, the increase over 1995 was 36.5%, and 1997 over 1996, the increase was 22.3%. Actual numbers of cases files in 1995 were 4207, in 1996, 5731 and in 1997 there were 7018. 1998 filings indicate a trend of continued increase in filings. Of interest, however, is that decreases have been noted overall for the district for chapter 11 and 12 cases.

BANKRUPTCY FILINGS IN THE EASTERN DISTRICT OF WASHINGTON

	Ch 7/% CHG 1996/1997	Ch 11/% CHG 1996/1997	Ch 12/%CHG 1996/1997	Ch 13/ % CHG 1996/1997	TOTALS 1996/1997
SPOKANE	2161/2605/30.0	38/36/-5.3	1/1/0	482/627/30.1	5731/7018/22.3
RICHLAND	977/1206/23.4	6/3/-50	1/1/0	98/128/30.6	1082/1338/23.7
MOSES LAKE	334/472/41.3	3/12/400	5/0/-100	48/22/-54	390/506/29.7
WENATCHEE	373/472/26.5	7/12/71.4	1/0/-100	17/22/29.4	398/506/27.1
YAKIMA	947/1114/17.6	5/3/-40	5/4/-20	222/337/51.8	1179/1458/23.7

The increase in our district is among the highest in the nation. Individual chapters and percentage of increases from 1996 and 1997 set out by geographic area in the table on this page.

Usage of Electronic Access

Electronic access to court records through PAS in 1997 accounted for 489 hours, 20 minutes and 43 seconds, which represents a decrease from 1996, during which 529 hours, 33 minutes and 1 second were used. This decrease in usage is most likely accounted for by the increased usage of VCIS which went from an average of 3321 calls per month in 1996, to an average of 4019 calls per month in 1997, an increase of 21%. Since the court's WEB site went on-line it has been accessed over 500 times. To sign up for PAS access, call 1-800-676-6856. In addition to case, adversary and claims dockets, the PAS user can also print MML's, the Local Rules, and Chapter 11 ballot information in addition to other items of useful information. VCIS is accessed by a touch tone telephone at 509-353-2404, extension 6, or toll free at 1-800-519-2549, extension 6. VCIS can provide basic case information and is accessed by debtor's name, social security number or case number. The court's WEB site address is www.waeb.uscourts.gov. Anyone interested in using any of these technologies should call Jo Jennings at 509-353-2404, extension 218 for assistance or additional information.

From the Clerk cont'd

Standing Advisory Committee

On December 18, 1997, and on March 13, 1998, the Standing Advisory Committee met in Spokane. This committee was formed to provide a method by which the court could receive input and comment concerning matters of mutual interest. Reviewing, suggesting and advising as to local rules is also within its charge. At its December meeting the committee discussed a variety of issues which included the adoption of a process for initiating changes to the local rules. A copy of the reports of the committee meetings are available from the Clerk, or on the WEB site at www.waeb.uscourts.gov.

Generally, the process for placing a proposed change on the agenda of a meeting of the committee would require a written draft of a proposed change to be submitted either to the Clerk of the Court or to any committee member, 60 days prior to the meeting of the committee at which the suggestion would be discussed. The meetings are set quarterly and the next meeting will be in conjunction with the annual meeting of the Association at Sun Mountain in June. Once the committee advises the court of the need for a change to a rule, the court would then move the suggestion along by providing the necessary notice to the public. Once the process is complete, the court could then amend the rule. The names, addresses and telephone numbers of the members of the committee were reported in the Fall 1997 edition of NOTES, and are also available on the court's WEB site at www.waeb.uscourts.gov.

Proposed Changes to Local Rules

Proposals for changes to the local rules of the court have been accepted by the Bankruptcy Judges, and those proposed changes are reprinted below for the purpose of allowing for public comment. In addition, the changes may be viewed on PAS or by accessing the court's WEB site at www.waeb.uscourts.gov. The comment period ends May 15, 1998. Comments should be in writing and sent to: Clerk, U.S. Bankruptcy Court, Eastern District of Washington, P.O. Box 2164, Spokane, WA 99210.

Rule 1007-1
Lists, Schedules, & Statements

(a) A debtor desiring an extension of time in which to file the schedules and statements, or chapter 12 or 13 plan and related documents shall give five (5) days notice and hearing to the trustee, the United States trustee, and any examiner or creditors committee appointed or elected. The motion shall be filed before the time for filing the schedules and statements or the time for filing a chapter 12 or 13 plan has expired, shall contain a brief statement as to the reason why an extension is required, and a specific date when the required documents will be filed.

(b) Each Item in the schedules and statement of affairs not otherwise filled out, shall be carried out by the entry "none" or "not applicable" as appropriate.

Note: FRBP 1007(c) requires that a motion for an order allowing an extension of time to file schedules and statements may be granted only after notice to the United States trustee, creditors committee, trustee, examiner and any other party as the court may direct. Notice of this kind of motion is not included in FRBP 2002. Application of LRBP 2002-1(b)&(c) would require 20 days notice to the Master Mailing List, unless less inclusive notice were prescribed. Many times a party will ask for an extension of less than 20 days. Requiring notice to the MML also seems excessive and overly burdensome. More interest is now being paid to the timely filing of schedules and statements, and plans, particularly in the Chapter 13 area, and a rule setting out time frames and notice requirements would be helpful. There is, however, no national requirement that the motion for an extension be filed before the time expires.

Rule 2007.1-1
Trustees & Examiners (Chapter 11)

Abrogated

Note: This local rule is now redundant to new FRBP 2007.1 which gives effect to 11 USC 1104(b) as amended by the Bankruptcy Reform Act of 1994. In accordance with the policy of not having local rules that are redundant of national rules, the local rule should be abrogated.

Rule 3016-1
Chapter 11: Plan

(b) ~~Election to be Treated as Small Business~~ *(Abrogated)*

Note: New FRBP 1020 now deals with the same matter dealt with by LBR 3016-1(b), and in keeping with the no-redundance policy, sub-section (b) should be abrogated.

Rule 3017-1
Disclosure Statement: General

(c) ~~Conditional Approval of Disclosure Statement~~ *(Abrogated)*

Note: Subsection (c) of LBR 3017-1 is now redundant to new FRBP 3017.1, and for this reason should be abrogated.

RULE 4003-1
Lien Avoidance

(a) A party seeking to avoid a lien pursuant to 11 U.S.C. 522(f) ~~need~~ *shall* give fifteen (15) days notice to the trustee and the creditor holding the lien. ~~The property encumbered, and the judgment lien or security interest to be avoided shall be specifically and clearly described in the notice and motion. LBR 2002-1 applies in all other respects.~~

(b) The notice and motion shall contain:

Your Contributions Are Welcome!

This edition boasts articles that are timely, relevant to our practice, and, as you can see, very well written. We need many more of such articles. And we know that the talent pool in our district has been barely tapped. Please submit your articles on a floppy disk (formatted in WordPerfect if possible).

Supreme Court Defines "Willful Injury"

By Ian Ledlin

The U.S. Supreme Court has changed the Ninth Circuit definition of "willful injury" for 11 U.S.C. 523(a)(6) discharge purposes.[1] The unanimous decision defining "willful injury" was delivered on March 3, 1998 in the case of *Kawaauhau v. Geiger*, ____ U.S.____ (1998).

In that case, Ms. Kawaauhau had lost the lower portion of her right leg due to Dr. Geiger's negligent medical treatment of an infection in her foot.[2] Kawaauhau recovered a $355,000 judgment against Geiger for the injuries he caused her to suffer. Geiger carried no malpractice insurance, and filed a bankruptcy petition as a means of dealing with Kawaauhau's judgment. Kawaauhau objected to the discharge of the debt, claiming that the debt was excepted from discharge as arising from a willful and malicious injury.

Kawaauhau advanced a *Cecchini*-like argument, asserting that Geiger's conduct was willful because he acted intentionally when he treated her, and that she was injured as a result. Geiger countered that he did not intend to cause any injury to Kawaauhau, and therefore the debt was dischargeable.

The Bankruptcy Court and the District Court agreed with Kawaauhau, but the Eighth Circuit did not and reversed, and its decision was affirmed by the Supreme Court. That Court noted that "willful" modifies "injury". This indicates "that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to an injury." The

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From the Clerk cont'd

(1) a description and statement of the value of the property encumbered as if there were no liens on the property;

(b) a description and the amount of the lien to be avoided;

(c) specific identification of the statutory authority for avoiding the fixing of the lien; either a judicial lien or a nonpossessory, nonpurchase-money security interest;

(d) a description and the amount of all other liens on the property, individually identified as to each lien holder, and a statement whether any such liens have or are subject to being avoided under this rule;

(e) a statement as to the specific statutory exemption used and the amount of the exemption claimed.

(c) Service of the notice on the lien creditor shall be in accordance with FRBP 7004.

Note: This draft includes the requirements that have been established by the court for the avoiding of liens. Also included is language intended to incorporate the requirements of 11 U.S.C. 522(f)(2)(A).

Rule 6008-1
Redemption

A debtor seeking to redeem property pursuant to 11 USC 722 shall give fifteen (15) days notice to the trustee and the creditor holding the lien. The property seeking to be redeemed shall be specifically and clearly described along with a statement as to its value in the notice and motion. Service on the lien holder shall be pursuant to FRCP 9014. LBR 2002-1 applies in all other respects.

Note: Although the practice noted in the Notice and Hearing tables describes who is to get notice and how it is to be given, there is no local rule on point. This suggested rule would provide needed local rule guidance.

Rule 9004-1
Papers: Requirements of Form

(a)(2) All documents presented for filing shall be pre-punched with two normal-size holes (approximately _ " diameter) centered 2-3/4 apart _" to 5/8" from the top edge of the document, and be single-sided. *Documents containing two or more pages shall be stapled at the top left corner, however, separate documents shall not be stapled together.*

Note: Multi-page documents that are not stapled together are subject to being inadvertently separated while being processed by the clerk's office, and separate documents that are stapled together are subject to being inadvertently misfiled.

(a)(10) Any document requiring the signature of the Court shall provide as follows:

Dated: ~~this ____day of ____19__.~~

_____
United States Bankruptcy Judge

Note: The words "this ____day of ____19__." should be deleted. The court uses a stamp to put the date on documents, therefore the words are not helpful.

Rule 9010-1
Attorneys: Notice of Appearance

(c) Eligibility to Practice

(1) Any attorney who is admitted to the bar of the United States District Court for the Eastern District of Washington is eligible to appear and practice before this Court.

(2) Persons who have been granted a limited license to engage in the practice of law pursuant to Rule 9 of the Admission to Practice Rules of the State of Washington may practice before this Court. Any person who practices under this rule shall comply with and be bound by the provisions of Rule 9.

Note: The proposed change is limited to sub-paragraph (a) of the existing rule, and would add as sub-paragraph (a)(2) eligibility to practice for Rule 9 interns. The remainder of the LBR 9010-1 remains unchanged.

Rule 9015-1
Jury Trial

Abrogated

Note: New FRBP 9015 address jury trials and the local rule should be abrogated as being redundant.

Rule 9070-1
Exhibits

(a) Identification and Presentation

As much as practicable, all exhibits intended to be offered into evidence shall be identified by the party offering the exhibit in the manner prescribed by the Clerk prior to the hearing. *A party intending to offer five or more exhibits shall furnish such exhibits in a three ring binder which shall include an index.*

Note: The proposed change would add a sentence to sub-paragraph (a) of LBR 9070-1; the remainder of the rule would remain unchanged.

E. Wash. Court Makes *Rash* Decision

The following is published in its entirety as it is a very recent application of the Rash *decision.*

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re:	)	
	)	No. 97-05293-W13
JONES, LARRY D.,	)	
	)	MEMORANDUM DECISION
Debtor.	)	
	_)	

THIS MATTER came on for hearing before the Honorable Patricia C. Williams on February 20, 1998 for a valuation hearing to determine the value of the Northland Credit Union collateral. Joseph Harkrader appeared on behalf of the Chapter 13 Trustee; Gregory Heline appeared on behalf of the debtor; and Theodore Schott appeared on behalf of Northland Credit Union. The court reviewed the files and records herein, heard argument of counsel and was fully advised in the premises. The court now enters its memorandum decision.

Debtors in this Chapter 13 proceeding own a 1992 all-wheel drive Dodge Caravan. The bankruptcy was commenced on September 25, 1997 and in their plan the debtors value the vehicle at $9,400. The lienholder Northland Credit Union was owed, as of the date of filing, $13,109.13. An objection to claim has been filed by the debtor and an objection to the Plan has been filed by the creditor. The valuation hearing was held on February 20, 1998 and both parties agreed that the value was to be determined as of the date of the commencement of the bankruptcy proceeding.

The debtor, Mr. Jones, testified that the value referenced in the Plan, *i.e.* $9,400, was based solely upon the wholesale NADA blue book for September, 1997 after appropriate additions and deductions for accessories and mileage. Mr. Bartlett, a self-employed vehicle appraiser, testified on behalf of the creditor and was qualified as an expert. He opined that the automobile had a value of $11,800. Mr. Bartlett's written appraisal was based upon an inspection of the vehicle and sales of comparable vehicles.

The ultimate question presented was the appropriate method to value vehicles in Chapter 13 consumer proceedings in the aftermath of *Associates Commercial Corp. v. Rash*, 117 S.Ct. 1879 (1997). In that case, the Supreme Court held that the allowed amount of a secured claim under § 506(a) ". . . is the price a willing buyer in the debtor's trade, business or situation would pay to obtain like property from a willing seller." The Supreme Court referred to this as the "replacement value" standard, but Footnote No. 2 also stated that ". . . Our use of the term replacement value is consistent with the Ninth Circuit's understanding of the meaning of fair market value . . . ." To those of us in the Ninth Circuit, "replacement value" may be a new term but it has the same meaning as our old friend "fair market value," *i.e.* what a willing buyer would pay a willing seller.

Bankruptcy courts throughout the Ninth Circuit regularly value assets. The relevant market is surveyed, the asset is inspected, and comparable sales are found. Nothing in *Rash* has changed this process. The relevant market for a debtor which is an automobile dealer or has regular access to the wholesale dealer market would be the wholesale market. For the average consumer Chapter 13 debtor, the relevant market is the retail market. The NADA or Kelly blue book reflects the largest portion of the market which is sales by used automobile dealers. However, private sales are also part of the market. Used vehicles are commonly sold to ultimate consumers by private individuals and businesses. Local newspapers daily advertise such sales and area publications such as Wheels Deals are devoted primarily to advertising and facilitating such sales.

In order to determine the fair market value of any asset, be it real estate, heavy equipment or a vehicle, the unique characteristics and condition of the asset must be determined. Through this process, the fair market value is determined. Not only *Rash*, but the cases interpreting it are consistent with this process.

Since *Rash*, Judge Small, in the Bankruptcy Court for the Eastern District of North Carolina, has concluded that nothing in the *Rash* decision precludes it from continuing to utilize the NADA retail blue book as the starting point to determine the allowed secured claim for a consumer automobile.

> The starting point for valuation of an automobile to be retained by a Chapter 13 debtor has been the NADA retail blue book with adjustments agreed to by the debtor, the secured creditor and the Chapter 13 trustee. If the parties do not agree, a hearing is held and the court determines the value using a replacement standard which in most cases is retail value. That practice has worked and will continue in this district.
>
> *In re Russell*, 211 B.R. 12 (E.D. N.C. 1997).

Judge Killian, in the Bankruptcy Court in the Northern District of Florida, however, concluded that nothing in *Rash* is inconsistent with its continued use of the average of the wholesale and

Supreme Court Defines "Willful Injury" *cont'd*

Court suggested that Congress would have written the statute to include additional words, such as "reckless" or "negligent", to also modify "injury" if it had intended to except from discharge debts arising from that kind of behavior.

The *Kawaauhau* Court made only passing comments about the meaning of "malice". It quoted a definition of "malice" as meaning "a wrongful act, done intentionally, without just cause or excuse."[3] *In Re Bammer*, ___ F3 ___ (9th Cir. (1998).[4] While this decision greatly increases a Ninth Circuit creditor's burden in establishing "willfulness", it is unlikely that this decision will change the outcome of Ninth Circuit cases that turn on whether the debtor had "malice" in his heart when inflicting the injury upon the victim. After proving that the debtor intended to cause the injury; however in most cases, a showing of "malice" is likely to follow with little difficulty.

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[1] *In re Cecchini*, 780 F.2d 1440 (9th Cir. 1986). See "Malice in the Ninth Circuit..." elsewhere in this Newsletter.

[2] In an effort to save money, Geiger had prescribed inexpensive medication that proved ineffective, and had countermanded Kawaauhau's referral to a specialist.

[3] This definition is similar to that adopted by the Ninth Circuit

[4] See *In Re Bammer*, 131 F.3d 788 (9th Cir. 1997).

E. Wash. Court Makes *Rash* Decision *cont'd*

retail NADA values as a starting point. *In re Franklin*, 213 B.R. 781 (N.D. Fla. 1997). In *Franklin*, the Florida court concluded that by expressly recognizing the various components which determine retail price such as warranties, reconditioning, etc., the Supreme Court has allowed bankruptcy courts to continue to measure replacement value at some point between wholesale and retail.

The Oklahoma Bankruptcy Court in *In re Younger*, 1998 WL 13681 (Bankr. W.D. Okla. 1998) thoroughly analyzed not only *Rash* but the above-referenced cases and concluded that nothing in *Rash* precluded it from utilizing the same approach it had taken before *Rash*. That approach was to average the wholesale and retail NADA values and use that as a starting point to determine the allowed secured claim. After determining the appropriate "starting point," all of these courts then examined the unique characteristics of the vehicle in question.

In re McElroy, 210 B.R. 833 (D. Or. 1997) was the only post-*Rash* decision reported in the Ninth Circuit. In that decision, the court recognized that the term "replacement value" as used in *Rash* is equivalent to the term "fair market value", *i.e.* the price that a willing buyer would pay a willing seller. The determination of value in that case was based upon a comprehensive evidentiary hearing with expert testimony.

This approach was heavily criticized by the Oklahoma court in *Younger*. Although conceding that requiring an evidentiary hearing with expert testimony would result in accurate valuation, the *Younger* court felt that such requirements were impracticable and "virtually impossible" to implement.

This court concludes that the appropriate methodology to determine the fair market value of vehicles being retained by consumer Chapter 13 debtors falls somewhere between the extensive evidentiary hearing required in *In re McElroy* and the strict mathematical calculations based upon NADA blue book used in other jurisdictions.

First, the NADA or Kelly blue book retail values are relevant to determine fair market or replacement value. The market for used vehicles which is available to consumer debtors is largely, but not entirely, dealers engaged in retail sales. These blue books are used daily by both purchasers and sellers and are reliable indicators of market price. All of the cases cited above allowed blue books as reliable evidence of value.

Secondly, as noted above, the market available to consumer debtors also consists of "private sales", *i.e.* sales by individuals or businesses of their own used vehicles. In the *Younger* case, one of the expert witnesses used two private sales as well as a sale by a dealer to determine his opinion of value. As was discussed in the *Younger* case, advertisements of sales prices, either by dealers or private parties, are relevant, but in order to most credibly determine fair market value, ". . . actual sales prices should be used."

Both *Rash* and traditional analysis of fair market values are based upon current area market prices for "like property." An opinion of value which is not based upon a physical examination of the vehicle at issue, is of questionable validity. The vehicle at issue may be in poor or excellent condition or may have defects. "Like property" requires the actual condition of the vehicle at issue to be considered. As stated in *In re Younger*, the weight of testimony is adversely affected if the witness has not inspected the automobile in question.

Much has been made of a single sentence in a footnote to the *Rash* decision to the effect that a retail value may not be replacement value unless certain dealer added items such as warranties and reconditioning are deducted. However, by considering as part of the market the private sales where such items are not added, much of the Supreme Court's concern is eliminated. More importantly, the physical inspection and comparable sales approach result in the adjustments contemplated by the *Rash* court being made. In fact, this is exactly what occurred in the *Franklin* case where the cost of reconditioning the vehicle for sale was deducted from the value. Also, in *McElroy*, the court deducted the cost of certain necessary repairs in determining value. There is nothing in *Rash* which mandates a different approach or which requires this or any court to determine profit margins and operation costs of automobile dealers to determine the fair market value of a vehicle.

Application to Facts

As the debtor primarily relied upon wholesale NADA value, his value is too low. This consumer debtor has no access to the wholesale market. The relevant market for this debtor is the retail market. Mr. Bartlett testified that he used the NADA only fleetingly to determine "where I am at." He does not rely primarily upon the NADA as a physical appraisal is "better." Value is based upon condition, mileage, any mechanical problems and the local market. He inspected the vehicle and relied upon advertisements for 1992 Dodge Caravans on the Internet, in Wheels Deals and in local newspapers. In his opinion, the relevant market for this particular vehicle is not the entire Pacific Northwest but the Inland Empire. He did, however, gather information from not only the Pacific Northwest but other areas. According to Mr. Bartlett, in late summer through early winter in the Inland Empire, 4-wheel drive or all-wheel vehicles sell for significantly more than NADA and significantly more than in some areas of the Pacific Northwest. He testified that for a vehicle of this type, $2,000 should be added to the NADA retail value. The debtor used the standard NADA add-on of $1,200.

The NADA categorizes vehicles by type and then determines a deduction for "high mileage." Mr. Bartlett determined this was a category II vehicle which should have a high mileage deduction of $500. The debtor was unable to articulate his deduction for high mileage, but indicated some deduction would be appropriate. Mr. Bartlett testified that in the market there are five classes of condition from Class 1 for "like new" to Class 5 for "bad." He placed this vehicle between average and high average so made no deduction or addition for condition. He did deduct for the condition of the tires and certain costs of preparing the vehicle for sale. This resulted in his opinion that the fair market or replacement value of the vehicle is $11,800.

There was considerable testimony regarding Mr. Bartlett's comparable sale as he relied upon advertised prices for that sale. His primary comparable sale was a sale by a private party, but the seller only indicated that the sales price was "close" to the advertised price. Mr. Bartlett testified that in his experience this would mean "$400 to $500" less than the advertised price. Because Mr. Bartlett's primary comparable sale was based upon an advertised price rather than an actual sale price, an adjustment to his opinion of value must be made. Using Mr. Bartlett's estimate, I find that the fair market or replacement value of the 1992 Dodge Caravan is $11,300.

The Clerk of Court is directed to file this Order and provide copies to counsel.

DATED this 9th day of March, 1998.

Signed PATRICIA C. WILLIAMS, Bankruptcy Judge

Ch. 13 Trustee's Corner

Daniel H. Brunner, Trustee

By now, of course, everyone is aware of the backlog of unconfirmed Chapter 13 cases which was developing by the beginning of the fourth quarter of calendar year 1997. As of October 15, 1997, there were more than 1,000 cases unconfirmed and more than $1.5 million held in trust associated with those unconfirmed cases.

With the assistance of the court, the clerk's office and the United States Trustee, a plan was developed to reduce and eliminate the backlog of unconfirmed cases. Central to this undertaking was a greatly expanded and far more aggressive approach to the scheduling and conducting of contested confirmation hearings. The court offered to provide more time on its docket to hear Chapter 13 matters, and Jake Miller and Gary Farrell from the U. S. Trustee's office offered to assist the Chapter 13 trustee in presenting the trustee's position on these contested matters. Such an effort has clearly placed a strain and a burden on the judges, the law clerks, the courtroom deputies, on the U. S. Trustee and the resources of the Office of the Chapter 13 Trustee. For example during the week beginning Tuesday, February 17, 1998, there were 71 Chapter 13 contested hearings scheduled in addition to two uncontested confirmation hearing dockets and a dismissal hearing docket.

All of these efforts are beginning to show results. In the first three months following the presentation of our plan the rapid growth of the unconfirmed backlog has not only been stopped, but has in fact been turned around. The backlog is now beginning to shrink and the volume of unconfirmed cases has been reduced from 1,014 on October 15, 1997, to 925 as of January 31, 1998. While at first blush this may not appear that we are making huge inroads into the backlog of unconfirmed cases, it must be remembered that close to 300 new cases were also filed in that same time frame. In each of the months of November, December and January, more cases were disposed of through confirmation, dismissal or conversion than were filed.

We are committed to reducing and eliminating this backlog and ask for everyone's patience, understanding and support as we go through this process. Your assistance in filing plans that are technically correct will be invaluable to us in our efforts to eliminate the backlog. As you can see, less than 30% of the cases filed are confirmable at the 341 meeting. While I recognize that it is difficult, if not impossible, to file plans in every case that will not draw an objection either from the trustee or from a creditor, it would be of immeasurable assistance if the plans filed were at least technically correct. (*e.g.* Make sure you're not proposing that the trustee disburse more money to creditors each month than the debtor is paying to the trustee). If you have questions about a Chapter 13 plan you intend to file, how a form should be filled out, etc., please don't hesitate to give my office a call. Any of the case administrators, Joe Harkrader or I would be pleased to discuss your proposed filing with you.

Statistics as of 01/31/98

	Filed	Confirmed	Dism. Pre-Conf.	Conv. Pre-Conf	Total Disposed	+/-
10/97	104	25	21	7	53	+51
11/97	78	45	25	12	82	-4
12/97	93	105	42	19	166	-73
01/98	88	76	28	14	118	-30
TOTALS	**279**	**251**	**116**	**52**	**419**	**-140**

Unconfirmed Case Statistics				
	10/15/97	**11/30/97**	**12/31/97**	**1/31/98**
Less than 90 days old	279	268	310	308
Between 90 and 180 days old			176	153
Between 90 and 270 days old	466	530		
Between 180 and 270 days old			241	215
Over 270 days old	269	203	257	249
	1014	**1001**	**984**	**925**

341 Statistics					
	11/97	**12/97**	**1/97**	**TOTAL**	**%**
Cases Scheduled for 341	81	102	83	266	
Cases Confirmable at 341	30	28	20	78	**29%**
Cases Objected to at 341	38	62	44	144	**54%**
Cases Rescheduled	6	5	10	21	**8%**
Cases w/Mot to Dismiss at 341	6	6	5	17	**6%**
Cases Conv/Dism Prior to 341	1	1	4	6	**3%**

Case Notes

By Jennifer Aspaas

These cases have been selected as representative cases containing typical recurring issues. The decisions in these cases should not be held as precedent.

Dismissals, Lack of Payment:

In re Fountain, 93-00854-W13

The mortgage holder filed a motion to lift the automatic stay for failure to make the regular mortgage payments which were to be paid "outside the plan". At the hearing in August the debtor filed an affidavit indicating that some of the alleged past due payments had been made. The motion was scheduled for a final hearing. However, before the final hearing the Chapter 13 Trustee's Motion to Dismiss for Lack of Payment was heard. The plan required payments of $438 per month and no payments had been made for approximately one year. The case was dismissed.

In re Kendrick, 93-01306-W13

The Chapter 13 trustee filed a motion to dismiss for failure to make plan payment. Payments under the confirmed plan were $1,097.24 per month and the debtor had not paid for 6 months. The debtor objected to the dismissal and filed an affidavit stating that due to loss of employment the debtor had been unable to make plan payments but that a modified plan would be filed based upon the debtor's new employment. At the hearing the following month, no modified plan had been filed or served and the case was dismissed.

Dismissals, Failure to File Amended Plan or Schedules:

In re Richmond, 97-02807-W13

This case came before the court on the contested confirmation docket. The Judge instructed debtor to file an Amended Plan and make a payment to the Chapter 13 trustee's office within two weeks. Failure to file the amended plan or make the required payment would result in dismissal of the bankruptcy. The debtor filed the amended plan but failed to make the required payment to the trustee's office. The trustee's office submitted an ex parte order requesting dismissal of the case. The court entered the order dismissing the case.

In re Opp, 96-04047-W13

At the initial hearing on confirmation the debtor was ordered to file an amended plan and new Schedules I & J by Sept 29 for a continued confirmation hearing set on Oct. 22. The debtor filed the amended plan and schedules on Oct. 16. The Judge dismissed the bankruptcy action for willful failure of debtors to comply with order of the Court. The debtors then filed a motion to reconsider asking that the case be converted to a Chapter 7. The court granted the motion.

In re McKnight, 97-04619-W13

The US Trustee filed a Motion to Dismiss for Failure to File Schedules Timely in this and numerous other cases. The US Trustee notified the debtor's attorney that such a motion would be filed if schedules and plan were not filed by a certain date. The schedules were not filed by the date specified. The schedules had been filed by the time of the hearing on the motion. The case was not dismissed at the hearing as this was the first time the issue had been presented, but the court indicated that in the future Motions to Dismiss for Failure to Timely File Schedules will be granted even though schedules are filed before the hearing on the motion.

In re Nagyfy, 96-03944-W13

At the initial confirmation hearing the debtors were ordered to file and serve a new amended plan and schedules I & J no later than Nov 24, 1997. The order stated that if the debtors failed to file and serve as ordered, the case would be dismissed based upon the Chapter 13 trustee's ex-parte presentment of an Order of Dismissal. The trustee filed an affidavit on Dec 8 indicating that the debtor had not complied with the previous court order. Debtor had filed his Amended Plan by the deadline, but failed to file revised Schedules I and J. The court entered an order of dismissal.

Dismissals, Failure to Attend the Meeting of Creditors:

In re Hentschel, 97-04598-W1B

This case came before the court on the Trustee's Motion to Dismiss for failure to attend the meeting of creditors. Debtor failed to attend two 341 meetings. The debtor made no effort to contact Trustee to reschedule the meetings to a date on which he would be available to attend. The Trustee filed a Motion to Dismiss after each meeting of creditors. The debtor objected to each motion stating that he was working out of town and was not available for the meeting. The court, stating it is the sole responsibility of the debtor to attend the meeting of creditors, dismissed the case.

Fees:

In re Pennington, 97-02774-W13

This case came before the court on the uncontested Chapter 13 plan confirmation docket. The plan required a monthly plan payment of $70.00 for 36 months and attorney's fees in the amount of $1,000.00 which were to be paid prior to all creditors except continuing claims. There were no continuing claims. Under the original plan the secured creditors would not receive a payment for approximately 16 months. The amount and priority payment of the attorney's fees prevented confirmation of the plan. The court denied confirmation of the plan and required the debtor to file a modification. The debtor filed a modification wherein the attorney's fees were to be paid prior to all creditors during the first two months of the plan and paid $48.00 per month thereafter. The court confirmed this plan as modified.

Administrative Freeze:

Whether a bank's administrative freeze of funds held in a bank account constitutes a setoff and thus, an avoidable preference under 11 U.S.C. 547?

In re Thorson, 97-04100-W13

In *In re Thorson,* 97-04100-W13 one of the material issues in a Motion for Relief from Stay revolved around whether the bank's administrative freeze of funds held in a savings account constituted an avoidable preference under 11 U.S.C. 547. The debtors signed a promissory note to the bank on November 12, 1996, with a principal amount of $5,513.29. The debtors did not make the monthly payments on the Note as required for the months of March, April, May, June and July of 1997. On July 18, 1997 the bank exercised its state law rights of setoff and froze the funds held in the debtors' joint savings account. The amount of the funds at the time of seizure was $3,367.69. The debtors filed a joint Chapter 13 on July 25, 1997. Ninety days prior to filing the joint savings account held $0.13.

The debtors' first allegation was that the administrative freeze of the funds constituted an avoidable preference under 11 U.S.C. 547. Section 547(b) provides that, subject to certain qualifications, the trustee may avoid any "transfer" of an interest of the debtor in property. Section 101(54) defines the term "transfer," but that definition does not include the term "setoff." The legislative history contained in the Editor's Comments reflects that the setoffs were omitted from the definition for the purpose of leaving in effect case law holding that a transfer does not include setoff for preference purposes. Rather, setoffs would be subject to the special rules of section 553(b) which applies the improvement of position test to setoffs made within three months of filing of the petition. Consequently, no transfer has occurred as the term is defined in section 547(b).

The second argument raised by debtor's counsel was that the provisions of 11 U.S.C. 553(b) allow the debtors to recover from the bank the amount of funds frozen in the debtors' savings account to the extent they exceed the account balance as it existed 90 days before the debtors filed its petition ($0.13). The debtors argued that the difference between the 13 cents and the $3,367.69 frozen represented the bank's improvement in position that section 553(b)

was intended to protect. State law determines the parties' right to setoff and section 553(a) preserves in bankruptcy, with certain exceptions, whatever rights that otherwise exist. The court found holding of *Citizens Bank of Maryland v. Strumpf*, 116 S.Ct. 286 (1995) controlling on the issue of whether or not an administrative freeze constitutes a setoff. An administrative freeze or hold is not a setoff, but rather a permissible means of maintaining the status quo pending resolution of the bank's right to exercise setoff. The three criteria typically required for setoff are: (1) a decision to effectuate it has been made; (2) some action accomplishing it has been taken; and (3) a recording of it has been entered. None of the criteria referenced by the Supreme Court as indicia of a setoff were evident in the facts before the Court. The court found a distinction between a declaration to offset funds once court approval has been obtained and an actual offset. Absent an offset, the improvement of position test found in section 553(b) does not apply. The court found that the recovery powers afforded the debtor under section 553(b) were not applicable to this case as an offset had not yet occurred. A final lift stay hearing was scheduled. The parties did not reach an agreement. Eventually the court entered an order lifting the automatic stay as the debtors were unable to provide adequate protection.

Lift Stay:

In re Erma J. Baer, 97-03498-W13

This case came before the court on a motion for relief from stay by the mortgage holder on the debtor's residence and an objection to confirmation. The debtor had made original proposed payments to the trustee's office with the exception of one payment. The mortgage holder argued that the debtor did not have the financial ability to pay the proposed monthly plan payments. The debtor wished to file an Amended Plan. The court required the debtor to file an Amended Plan by a specific date. Failure to file the Amended Plan subjected the case to dismissal upon presentment of an ex parte order by the Chapter 13 trustee's office. The court scheduled the confirmation hearing on the amended plan and final lift stay hearing three months in the future to allow the debtor to serve and file the Amended Plan and to establish a consistent payment history. The debtor timely filed the Amended Plan and made the required payments over the three month period. The court denied the motion for relief from stay.

Contributions to 401(k) in Chapter 13:

Whether Contributions to a retirement plan are to be considered income for the purposes of section 1325(b)?

In re Nowaski, 97-00161-W13

This case came on for hearing upon the Chapter 13 trustee's Motion to Dismiss. The issue before the court was whether contributions to pension funds or retirement plans are income for the purposes of section 1325(b). The debtors were voluntarily contributing $200 per month to a 401K pension plan. The trustee objected to the confirmation alleging that the 401(k) pension contributions constituted disposable income which must be contributed toward the funding of the Chapter 13 Plan. The court, citing *In re Cavanaugh*, 175 B.R. 369 (Bankr. D. Idaho 1994) and cases contained within that case as persuasive authority, determined that voluntary contributions to a pension fund or retirement plan are not necessary for the maintenance or support of the debtor. Thus, the amount of the contribution is income for the purposes of section 1325(b). The voluntary contributions to the retirement plan were not allowed. The court required the plan be modified increasing the monthly plan payment by the amount of the pension fund contribution.

By Bev Benka

PMSI Lost Upon Refinancing

In re Anderson, 96-05493-K1R, November 26, 1997

The debtor filed for relief under Chapter 7, and subsequently moved to avoid the lien of American General Finance, Inc. ("American General") in a suite of bedroom furniture which had been exempted as household goods. American General objected to the motion on the basis that it held a purchase money security interest ("PMSI") which was not avoidable under 11 U.S.C. § 522(f).

Prior to the bankruptcy, the debtor purchased the bedroom furniture from Smith's Home Furnishings and promised to pay the total purchase price of $3,016.43 pursuant to the terms of a retail installment contract. The contract provided that the full amount was due 12 months from receipt of the merchandise and the stated interest rate was zero percent. The contract stated that the buyer was giving a security interest in the property purchased and referenced the sales order which specifically described the property. The reverse side of the contract contained an assignment of the contract and goods to American General.

The debtor was unable to pay the debt as agreed, and applied for a loan with American General to refinance the obligation. American General agreed to refinance the debt. On May 29, 1996, the debtor executed a promissory note wherein she agreed to pay American General $2,916.43, together with interest at an annual percentage rate of 29.14%, over a 24-month period in monthly installments of $162.48. The section in the pre-printed promissory note designated for entering the collateral was left blank. The original retail installment contract was stamped "PAID BY RENEWAL, May 1996."

In conjunction with the promissory note, the debtor signed a federal disclosure statement which contained a statement providing that a security interest was being given and included boxes to be checked regarding the type of property securing the debt. The box next to "other" was checked and the following statement was typed in: "Retain purchase money agreement on chestnut creek tv wardrobe, ... purchased at Smith's on 4/7/95." On June 12, 1996, American General filed a UCC-1 Financing Statement listing the collateral for the debt as "[a]ll property listed as security in a certain 'Federal Disclosure Statement' executed by and delivered to the Mortgagor(s) on even date."

At the hearing on the motion to avoid the lien, it was not disputed that American General held a purchase money security interest in the property as the assignee of the retail installment contract at the time of purchase or that American General held a security interest when the obligation was refinanced. The question was whether the security interest retained its purchase money status upon refinancing.

Judge Klobucher relied on *In re Matthews*, 724 F.2d 798 (9th Cir. 1984), in deciding that refinancing the original loan destroyed the purchase money nature of the security interest for purposes of Bankruptcy Code § 522(f). To acquire a purchase money security interest, the creditor must provide value which enables the debtor to acquire rights in the property. Here, as in *Matthews*, the creditor provided value to pay off the initial loan, not to enable the debtor to acquire rights in the property. The debtor already owned the property. Since the security interest did not maintain its purchase money status upon refinancing, it was avoidable under 11 U.S.C. § 522(f).

Who's In Control?

Kal Miss, Inc. v. Roy Stanley Chevrolet Co., A96-0120-K11 November 14, 1997

In this adversary proceeding, the debtor/plaintiff sought to maintain a preference action pursuant to 11 U.S.C. § 547 against defendant, alleging that defendant had deprived the debtor/plaintiff of $350,000 of the debtor's assets. The defendant moved for summary judgment on the basis that plaintiff had no cause of action. The plaintiff agreed that establishing the "insider" status of the defendant was elementary to maintaining the cause of action. Specifically, the plaintiff asserted and had to prove that the defendant was a "person in control of the debtor" under 11 U.S.C. 101(31)(b)(iii).

In 1992, the plaintiff debtor purchased an automobile dealership in Kalispel, Montana, from the defendant. A substantial portion of

the purchase price was supported by a promissory note. This note was in turn supported by the pledge of a third-party obligation. It was anticipated that payment of the third-party obligation would retire the plaintiff's obligation to the defendant. However, the third-party defaulted, leaving the plaintiff unable to meet its remaining obligation on the note held by the seller of the dealership. The plaintiff was without means to cure the default and sought to sell the dealership. The plaintiff entered into negotiations with two separate parties who showed an interest in purchasing the dealership. Consummation of the sale, however, was dependent upon the purchaser's assumption of the plaintiff's obligation to the defendant, and that assumption required the approval of the defendant. Consequently, a principal of the defendant became involved in the negotiations. Ultimately, a sale was concluded under terms which were accepted by all three parties.

In its complaint, the plaintiff asserted that the defendant, by way of its authority to approve the assumption, was in a position of control over the business judgment of the plaintiff. The plaintiff further contended that as a result of that control the plaintiff was forced to accept the terms of a sale which were less favorable than it would have accomplished without the "interference" of the defendant.

Judge Klobucher, in his decision granting the defendant's motion for summary judgment, noted the relevant case law does not present a uniform definition of the term "person in control of the debtor," however, there is uniform agreement that mere financial leverage with the ability to exercise contractual rights is not sufficient to satisfy the term. Judge Klobucher found that the record in the case was devoid of any scintilla of evidence which would demonstrate that the defendant was in a position of control over the plaintiff as that term is contemplated by the Bankruptcy Code.

No appeal was filed within the 10-day period prescribed by FRBP 8002. Subsequently, the plaintiff filed a motion to extend the time to file an appeal based on excusable neglect and the motion was granted. The defendant has appealed the order extending the time to file the appeal and that matter is currently pending before Judge Nielsen, United States District Court. The plaintiff's appeal on the substantive issue is currently pending before the Bankruptcy Appellate Panel.

Who's Interested?

In re Southern California Limited Partnership, Bankruptcy Case No. 96-03301-K11; *In re Fontana Properties Limited Partnership*, Bankruptcy Case No. 96-02980-K11, November 3, 1997

In these two related bankruptcy cases, Washington Trust Bank, who was not a creditor or other party enumerated under 11 U.S.C. § 1109, entered a notice of appearance and objected to the debtors' disclosure statements. In each case, the debtor moved to strike the pleadings of Washington Trust Bank and dismiss it from the proceedings. Washington Trust Bank objected to the motion and a hearing was held wherein the determinative issue was whether Washington Trust Bank was a "party in interest" as contemplated by 11 U.S.C. § 1109(b), and, therefore, entitled to be heard in the cases.

Judge Klobucher found that Washington Trust Bank was unable to show any relationship with the limited partnerships, other than the fact that the debtors presently held assets which were once possessed by a related entity which guaranteed the debt of yet another related entity. That fact was insufficient to give Washington Trust Bank a proprietary interest in the property.

In his decision granting the debtors' motions, Judge Klobucher noted that the term "party in interest" enjoys a broader interpretation under § 1109 when applied to participation in a main case under the Bankruptcy Code than it receives under an adversary proceeding or a lawsuit outside the context of bankruptcy, and rightly so. He went on to say, however, that there are limits to the right to participate, particularly when that participation is likely to cause unreasonable or unnecessary delay in a resolution of the bankruptcy case. Judge Klobucher opined that Washington Trust Bank's intervention in these cases was intended precisely to delay resolution of the bankruptcies and distribution of the assets until it had some unspecified time to explore theories by which it might seek to impress an interest upon the assets of the estates which it did not presently hold.

By Tom Hinshaw, Law Clerk to Judge John M. Klobucher, Central District of California

Judge Klobucher was temporarily assigned to the Central District of California, at Santa Barbara, to assist Judge Robin Riblet for the months of December '97 and January '98. The Central District of California is the busiest bankruptcy court in the nation and Judge Riblet hears all matters involving debtors from San Luis Obispo and Santa Barbara Counties as well as most of Ventura County. Selected rulings from Judge Klobucher's California docket are set out below.

Judge Klobucher awarded a $4,950,000 judgment in *Alberg, et al., v. IDM Corporation (In re Harbor Plaza, Ltd., et al.)*. As part of a settlement and plan of reorganization, the debtors and a secured creditor agreed to draw down on letters of credit secured by letters of credit of the plaintiffs/limited partners. Then, the creditor refunded the money to one of the debtors. The judge found that the money paid to the creditor belonged to the plaintiffs and that the debtors received the money twice, once at the time of the original loan and again when the creditor gave debtors the plaintiffs' money. Yet, the debtors owed the creditor only the balance of the initial loan. The Judge determined that the order confirming plan did not bar the plaintiffs' action because the plan did not purport to deal with the claims of plaintiffs and because the debtors had induced the plaintiffs' consent to the plan by offering a settlement, which the debtors withdrew after confirmation.

Judge Klobucher heard *Farmer v. Craemer (In re Craemer)*, ND 96-12599 RR, Adv. No. 96-1336 (C.D. Cal.), an action by a Chapter 7 trustee to revoke a debtor's discharge for alleged fraud. In the bankruptcy case, debtors omitted from their schedules some shares of stock and a 20% interest in real property. At the initial 341(a) meeting in August, 1996, debtors failed to disclose the omitted assets. Prior to the continued meeting, someone other than the debtors informed the trustee about the omitted assets. Debtors disclosed the assets at the continued 341(a) meeting in September, 1996, only after the trustee asked specific questions identifying those assets. They amended their schedules on September 30, 1996, to reflect $2,250 value of the shares and $36,400 value of their interest in the property. The clerk of the court entered the order of discharge on October 11, 1996. Judge Klobucher ruled against the trustee on the complaint for revocation of discharge. The trustee relied on 11 U.S.C. § 727(d)(1), which provides for revocation of discharge if "such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge." The judge determined that Ninth Circuit authority clearly establishes two criteria for revocation under § 727(d)(1). First, the debtor must have committed a fraud in fact which would have barred the discharge had the fraud been known. Second, the fraud must be discovered after discharge. Since the trustee knew of the omission of the assets from the schedules before the deadline for filing an objection to discharge, his sole option was to object to the discharge at the time. Since the trustee failed to do that, he was barred from later seeking revocation of the discharge.

In *Bednark v. Sprague (In re Sprague)*, ND 96-13029 RR, Adv. No. 96-1302 (C.D. Cal.), Judge Klobucher gave collateral estoppel effect to an award of attorney's fees in a Nevada state court and determined the award to be nondischargeable pursuant to 11 U.S.C. § 523(a)(6). In the Nevada court, the debtor was the plaintiff. The Nevada court had found that the debtor's complaint lacked good faith and that the

debtor had proceeded with the litigation "unreasonably and harassingly." Judge Klobucher granted summary judgment in the amount of $52,006.81 to the plaintiffs on the ground that the Nevada findings constituted wilful and malicious injury under § 523(a)(6).

In re Public Information Services, Inc., ND 97-10387 RR (C.D. Cal.), presented unique issues of the treatment of the pre-petition fees and expenses of an assignee for benefit of creditors in a subsequent bankruptcy. The Assignee recovered and liquidated $107,545.90 in assets and disbursed $28,705.36 in expenses. During the course of the Assignee's administration of the assignment, the California Division of Labor Standards Enforcement (the "DLSE") filed suit in the Ventura Superior Court alleging that wage claims had priority over the claims of the Assignee and other claimants pursuant to California law. 11 U.S.C. § 543(c)(1) provides that the bankruptcy court will protect the entities to which a pre-petition custodian has become obligated. However, under 11 U.S.C. § 503(b)(3) and (4), the fees and expenses are subject to bankruptcy court scrutiny. Judge Klobucher concluded that 1) pre-petition fees and expenses of professionals and others to whom an assignee is obligated are allowable as administrative expenses; 2) all fees and expenses must benefit the estate to be allowed (citing an opinion by Oliver Wendell Holmes); 3) post-petition fees and expenses may relate only to the preservation of assets, turnover, accounting and allowance of fees and expenses, and specifically cannot include opposing an involuntary petition; and 4) to the extent allowed, an assignee's pre-petition fees and expenses are entitled to first priority from the assets turned over to the bankruptcy estate by the assignee.

The Assignee ran up over $45,000 in attorney's fees, primarily fighting the priority issue. When the Superior Court issued a preliminary injunction restraining the assignee from distributing assets held, the Assignee facilitated an involuntary Ch. 7 bankruptcy petition against the Debtor by "disgruntled creditors," thereby invoking the federal bankruptcy claims priorities. Judge Klobucher denied almost $40,000 of the attorney's fees because the fight over claims priorities under unsettled state law in Superior Court was completely unnecessary in light of the very clearly defined system of priorities under the bankruptcy option. The judge allowed the "administrative" claims of the Assignee and his other professionals in full.

By Sandee Gabriel

Whether Debtor's failure to provide sufficient notice to the IRS to permit meaningful participation in their chapter 13 proceeding precludes dischargeability of their tax liabilities?

In *Ibrahims v. United States*, A96-0183-R33, October 30, 1991 Ibrahims received a notice of tax deficiency from the IRS for the years 1987-1988. They filed their chapter 13 petition two weeks later, November 12, in large part to deal with the tax debt, although there was some dispute as to whether Debtors' counsel was informed of the tax problem at that time. The IRS was neither listed nor scheduled as a creditor. The claims bar date expired March 1, 1992. March 20, 1992 the IRS, without knowledge of the chapter 13 case, assessed 1987 and 1988 income tax liabilities. The Debtors informed its counsel of the assessment and July 10, 1992 their counsel prepared amended schedules listing the IRS claim of $161,533 as disputed and sent a notice of stay to the IRS. However, the amended schedules were never filed nor was the mailing list amended to include the IRS. After receipt of the notice of stay, the IRS abated the earlier assessment and investigated the Ibrahim case and confirmed the bar date had passed but did not intervene in the case. The Debtors' plan included the provision that "all priority claims as defined in § 507 shall be paid in full in deferred cash payments over the term of the plan". The plan was confirmed December 31, 1992 and an order of discharge entered April 25, 1995. The IRS subsequently reassessed the $160,000 tax liability and the debtors filed this adversary action to determine whether the taxes had been discharged by virtue of their chapter 13 plan. Both parties filed motions for summary judgment.

The Debtors argued the IRS could have filed a late claim or objected to confirmation, relying on *In re Ryan*, 78 B.R. 175 (Bankr. E.D. Tenn. 1997); *In re Leber*, 134 B.R. 911 (Bankr. D. Ill. 1991); *In re Crites*, 201 B.R. 277(Bankr. D.Or. 1996) and *In re Vaughn*, 151 B.R. 87 (Bankr. W. D. Tex. 1993). The IRS asserted FRBP 3002(c)(1) does not provide for an extension of time after the bar date has expired, and even if it could have filed a late claim, it should not be required to do so in such a late stage of the bankruptcy proceeding; alternatively, failure to schedule the claim cannot be construed to "provide for the claim" in the plan, relying on *In re Pack*, 105 B.R. 703 (Bankr. M.D. Fla. 1989); *In re Tomlan*, 907 F.2d 114 (9th Cir. 1990); *In re Coastal Alaska Lines*, 920 F.2d 1428 (9th Cir. 1990); *In re Trembath*, 205 B.R. 909 (Bankr. N.D. Ill. 1997); *In re Maya*, 78 F.3d 1395 (9th Cir. 1995); *In re Hairopoulos*, 193 B.R. 889 (E.D. Miss. 1996).

Judge Rossmeissl balanced the IRS failure to intervene, albeit late, with the Debtors' multiple failures to adequately notify the IRS and deal with the tax problem and decided the burden should fall on the Debtor for resolving the claim. This was especially true in light of the 9th Circuit case law following *Tomlan* , i.e., *In re Hobdy*, 130 B.R. 318 (9th Cir. BAP 1991), *In re Beltran*, 177 B.R. 905 (9th Cir. BAP) and *In re Osborne*, 76 F.3d 306 (9th Cir. 1996) which affirms a strict construction of Rule 3002. The court found the plan did not "provide for the IRS claim" by virtue of the Debtors' failure to give sufficient timely notice to permit the IRS to meaningfully participate, thereby barring discharge of the tax claim.

Whether defalcation of money held in trust as custodian under the Uniform Transfer to Minors Act constitutes an express trust bringing it within the nondischargeability provisions of § 523(a)(4)?

In *Peter and Molly McDowell and Sarah Lutz v. Roger McDowell*, No. A97-0096-R2N, Roger McDowell, acting as trustee for the parties children, took funds from the dissolved marital community which had been invested for the children's future educational needs and invested them in penny stocks, a highly speculative form of stock. Within 60 days, the stock was valueless. The children were unaware of the loss until Mr. McDowell responded to inquiries four years later. Sarah Lutz, the mother and guardian ad litem for the children, brought suit against Mr. McDowell alleging negligence and breach of fiduciary duty based on mismanagement of funds in his role as trustee. Mr. McDowell entered into a stipulated judgment acknowledging the debt and subsequently filed a chapter 7. This action to determine dischargeability was brought under § 523(a)(4) which excepts from discharge a debt for defalcation while acting in a fiduciary capacity. The plaintiffs moved for summary judgment.

As held in *In re Niles*, 106 F.3d 1456 (9th Cir. 1997) Judge Rossmeissl held §523(a)(4) requires 1) an express trust, 2) the debtor acted as a fiduciary at the time the debt was created, and 3) the debt was caused by the defalcation. First, the court found the taking of the res, the money, was a transfer under the Uniform Transfer to Minors Act, thereby creating an express trust. RCW 11.114. Next the court applied *In re Lewis*, 97 F.3d 1182 (9th Cir. 1996) which held the issue of whether one is a fiduciary is a question of federal law but that whether a fiduciary is a trustee in determined by reference to state law. The court found RCW 11.114.120(2) which provides that a custodian must observe the standard of care applicable to fiduciaries placed a fiduciary standard of care on Mr. McDowell at the time he made the investments. Last, the court held RCW 11.100.023 which precludes a fiduciary from investing more than 10% of assets held in investments in "new, unproven, untried or other enterprise" was violated by investment in the highly speculative stock. Mr. McDowell

Case Notes *cont'd*

argued that although the investments may have been "stupid" it was not done with any malice. Citing *Lewis*, the court stated defalcation includes innocent as well as intentional or negligent actions. As in *In re Johns*, 191 B.R. 965 (Bkrcty. D. Arizona 1995)(holding debtor, as custodian breached his fiduciary duty to his son under the Uniform Transfers to Minors Act and liable for defalcation under 523(a)(4)), the court here likewise held Mr. McDowell was liable for the defalcation of funds while acting as a fiduciary for his children, thereby excepting the debt from discharge.

Who gets priority when there are competing liens in crops and proceeds pursuant to RCW 60.11 and does a confirmed plan affect the outcome?

Judge Rossmeissl addressed several related issues regarding the interplay of the code, the plan and Washington's state crop lien statute in *David and Karen Rickenbach*, No. 92-00519-R22, a Ch. 12, and *Pacific Produce v. Jake's Produce Inc. and Jerry Keith*, No. A97-0082-R51, a Ch. 11. In *Rickenbach*, the debtor had been operating under a confirmed plan since November 12, 1992. April 11, 1997 the landlord and Debtor entered into a farm lease for 1997 secured by the 1997 crop. The Debtor also made arrangements with a supplier to supply fertilizer and chemicals for the growing crops. The supplier filed a financing statement covering the 1997 crop April 21, 1997. The landlord filed its financing statement on the crop June 13, 1997. The landlord filed a motion with this court for a superpriority lien, to which the supplier objected.

The supplier contended the court no longer had jurisdiction based on Article 5 of the confirmed plan which provides for revesting the property in the Debtor upon confirmation and thus the Debtor did not need to seek bankruptcy approval for post confirmation funding. The court agreed in part and disagreed in part. It noted that the court retains jurisdiction until the case is discharged; in the case of a ch. 12 or 13, unlike a ch. 11, discharge occurs after the plan is completed. 11 USC §1228, 11 USC §1328. However, generally the property in a ch. 12 or 13 revests in the debtor upon confirmation. 11 USC §1227 and 11 USC §1327. Consistent with those provisions, the court noted because the plan provisions provided for vesting of the property upon confirmation, the Debtor was free to seek new financing without court approval as long as the actions taken were consistent and did not violate any of the plan provisions. The court held the parties needed to look to state law to determine the priority between the landlord and suppliers lien. RCW 60.11.050; *In re Esparza*, 118 Wn.2d 251, 821 P.2d 1216 (1992).

A slightly different issue was presented in Pacific Produce. In that case, Pacific filed an adversary to determine the priority of supplier liens in a crop produced by Keico Industries. Pacific had filed its lien March 25, 1996 for the 1996 potato crop. Jake's Produce contracted to harvest the potatoes and commenced work August 7, 1996. August 23 Keico filed a chapter 11 petition. August 26, Jake's Produce filed its lien on the harvested crop which was also subject to Pacific's lien. Pacific and several other lien claimants entered into a court approved compromise of their claims, leaving this disputed claim to be resolved by the court. Although one of the issues raised was the interpretation of the court approved compromise since it is not relevant to the discussion of the crop lien statute, it will not be addressed here.

Judge Rossmeissl held the lien filed by Jake's Produce after the filing of the bankruptcy violated the automatic stay pursuant to 11 USC 362(a)(4). The court found the lien statute provides that attachment only occurs upon filing pursuant to RCW 60.11.030(1) and consequently was arguably void if it did not come within the provisions of 346(b)(3), 546(b) or 547(e)(2)(A) which recognize the validity of a lien if there is a statutory provision for relation back prior to filing the petition in bankruptcy. The court noted RCW 60.11 does not contain any provision for relation back of the lien, and therefore held the filing of the lien after the bankruptcy filing was void. *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992). The court noted in dicta, even if the lien had been properly perfected, the priorities established in RCW 60.11.050 would have established that Pacific's lien which was filed first in time would have the right to claim the proceeds.

A Word of Caution! A proceeding to enforce collection of prepetition judgment is a violation of the discharge injunction under 11 USC 524(a)(1).

In *In re Glenda Ensminger*, 95-01231-R3C, a creditor obtained a default judgment against the Debtor and Mr. Johnson who were living together but were not married. The judgment was obtained against them individually and against the marital community. The Debtor filed a ch. 7, listing the creditor's judgment and received a discharge. The Debtor then married Mr. Johnson. The creditor, with knowledge of the bankruptcy and discharge, obtained a writ of garnishment against the community bank account constituting Debtor's post discharge, post marriage earnings. The Debtor's motion to quash the garnishment on the basis of the discharge was denied by the state court and the debtor sought relief in this court. The creditor argued the subsequent marriage of the parties "resurrected" the liability of the community which was not affected by the Debtor's discharge since the bankruptcy was filed in only her individual capacity.

The court disagreed. Judge Rossmeissl held that the default judgment imposed only separate liability against the Debtor and Mr. Johnson since there was no marital community at the time it was obtained and there was no authority to "resurrect" the liability against the community by virtue of the subsequent marriage. Consequently, the debt as to the Debtor was discharged and only Mr. Johnson was subject to continued liability of the debt in his separate capacity. Further, pursuant to RCW 26.16.200, the Debtor's community earnings were not subject to the separate liability of her spouse. Alternatively, the court held that, even assuming, the judgment was valid against the fictitious marital community at the time it was taken, the Debtor's filing of the bankruptcy discharged the separate liability and any community liability pursuant to 11 USC 541(a). The court found the actions of the creditor were a willful violation of 524(a) and awarded debtor attorney fees incurred in bringing the action.

Postscript: An action against a creditor for violation of the discharge injunction should be brought as an adversary action pursuant to FRBP 7001(7) rather than as a motion to re-open the case. A Debtor bringing such action as a plaintiff in an adversary action is not required to pay a filing fee in contrast to the filing fee which is required to reopen a case!

Ch. 7 Discharge Denied

By Robert D. Miller Jr.

The chapter 7 debtors operated a small retail clothing store in Chelan, Washington, for 10 years. In 1996, their last year of operation, the debtors ran up over $1 million in unsecured trade debt. When their doors closed at the end of the year, virtually no inventory or other assets remained on hand. The United States Trustee commenced an adversary proceeding to deny the debtors a discharge.

At trial, the debtors testified that much of their operation was conducted in cash and that many of their business records had been destroyed when the business closed. They further testified that debtor husband was a compulsive gambler who had lost hundreds of thousands of dollars in Nevada and at the Mill Bay Casino near Chelan. The debtors offered little evidence other than their own testimony to document their gambling losses. The debtors were occasionally unable to fully explain various checks shown as "Loans", "Family Savings", or "Cash", written to friends and relatives from their business checking account.

Judge Rossmeissl found portions of the debtors' testimony not credible. He held that the debtors had "failed to explain satisfactorily" their loss of assets, 11 U.S.C. §727(a)(5), and denied their discharge. *United States Trustee v. Sarameh*, 97-00191-R4B.

Malice in the Ninth Circuit: No Willful Deed Goes Unpunished

By Ian Ledlin

Intentional torts are excepted from discharge in Chapter 7 bankruptcy cases.[1] Some examples are obvious: Debts based upon injuries arising from converting property of another or shooting a victim while committing a crime generally will not be discharged. The discharge of claims arising from injuries caused by a debtor's negligence can be denied in certain cases. Tort victims faced with a debtor who files a Chapter 7 case will often consider bringing a dischargeability action against the debtor/tortfeasor.[2] Whether the claim will be discharged will depend on whether the debtor's actions are "willful and malicious".

The lead Ninth Circuit case determining what constitutes a "willful and malicious" injury excepting a debt from discharge under 11 U.S.C. 523(a)(6) is *In re Cecchini*, 780 F.2d 1440 (9th Cir. 1986). Mr. Cecchini was a tour broker. He contracted with Impulsora to find guests for Impulsora's hotel. His agreement with Impulsora required him to advance all expenses and remit all deposits to Impulsora, who would then reimburse Cecchini's expenses. Cecchini hired an agent to obtain bookings at Impulsora's hotel, who forwarded the deposits directly to Impulsora. Cecchini began to suspect that Impulsora was not reimbursing his expenses as provided by the agreement. Cecchini induced the agent to forward the deposits to him, rather than paying them over to Impulsora. When Impulsora realized it was not receiving the deposits, it sued Cecchini and obtained a stipulated judgment against him for the converted funds. Later, Cecchini sought to discharge that obligation in a Chapter 7 bankruptcy proceeding. Impulsora objected to discharge of the debt, claiming that Cecchini's conversion was a willful and malicious injury.

Cecchini argued that an intent to cause injury must be proved as a necessary element of a "willful" act. The Bankruptcy Court and the BAP accepted this as the standard that Impulsora must prove. The Ninth Circuit reversed, accepting the definition advanced by Impulsora: "Willful" means an intentional act that causes an injury.[3] As a result of this decision, it is not too difficult for a tort victim to show "willfulness" by the tortfeasor. For example, a hunter who accidentally shoots another is acting "willfully" because he intentionally pulled the trigger even though he thought he had a bear in his sights.

Establishing "willfulness" by itself is not enough to render the debt nondischargeable. The creditor must also prove the debtor's act was "malicious".

The *Cecchini* Court prescribed a four-part definition of "malicious" as "a wrongful act ..., done intentionally, [which] necessarily produces harm and is without just cause or excuse ...."[4] It found that Cecchini's "wrongful act such as conversion, done intentionally, [which] necessarily produces harm and is without just cause or excuse, ... is 'willful and malicious' even absent a specific intent to injure."

The Ninth Circuit recently applied the *Cecchini* meaning of "willful and malicious" to the §523(a)(6) discharge exception in the case of *In re Bammer*, 131 F.3d 788 (9th Cir. 1997). There, Steven Bammer had conspired with his mother, Alta, to thwart collection of restitution of money embezzled by Alta from Murray. To effectuate their scam, Steven borrowed $50,000 and secured it with a third mortgage against Alta's home.[5] He then gave the money to Alta, who paid her criminal lawyer and used the rest for personal expenses. This prevented Murray from collecting his restitution from the equity in Alta's home. Murray sued Steven and Alta in state court, and obtained $108,000 judgments against each of them. Steven, who had no intention of repaying the loan, filed a Chapter 7 bankruptcy case, seeking to discharge the judgment owed to Murray. Murray brought an adversary proceeding to determine that the debt was not dischargeable as a willful and malicious injury.

The *Bammer* Court discussed the meaning of "willful and malicious" as crafted by the *Cecchini* Court. It adopted the Cecchini concept of a "willful" act as being only an intentional act that causes injury, along with the four elements of a "malicious" injury: "(1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse."

The Bankruptcy Court and the BAP found that the first three elements of "malice" applied to Steven's conduct: He wrongfully deprived Murray of his ability to realize upon his claim against Alta; he did so intentionally, and his act necessarily injured Murray. Steven's defense was that the fourth element was not met: His acts were done out of compassion for his mother's plight; therefor he had just cause or excuse for his conduct. Because those Courts found that Steven's compassion was sufficient just cause to remove his actions from the purview of "malice", the debt to Murray was discharged.

The Circuit Court reversed. It ruled that the purposes of the Bankruptcy Code do not "permit a standardless, unmeasurable, emotional, and nonlegal concept as compassion to negate an identifiably and legally wrongful act." The Court was not impressed with Steven's claim of compassion for his mother because he expressed no similar compassion for his mother's victims.

The *Bammer* Court supplemented the *Cecchini* decision by elaborating on the meaning of "just". It cited dictionary definitions of "just" as meaning "honorable and fair in dealings and actions", "consistent with moral right", and "valid within the law". It noted that helping an embezzler avoid restitution is not a just cause.

The *Cecchini* and *Bammer* Courts appeared to examine their respective debtors' motives when determining whether an act was "willful and malicious". In *Cecchini*, the Court discussed the "nature of the act" (i.e., conversion of another's property); in *Bammer*, the Court distinguished Steven's wrongful behavior from "an ordinary business transaction gone sour", and found that it was "neither honest nor the product of misfortune."

A plaintiff in a §523(a)(6) action must focus on proving each of the components of what constitutes a "willful and malicious" act. (A successful debtor will need to show that at least one of the elements does not apply in his case.) The plaintiff must prove that the debtor's act caused an injury to the plaintiff. (The debtor wins if the plaintiff cannot prove he was injured by the debtor.) The act must be wrongful. (The debtor wins if he did nothing wrong, even though the plaintiff was injured.) The act must *necessarily* cause harm to the plaintiff. (The debtor wins if the Court can be convinced that the debtor's act is one that ordinarily would not cause an injury.) The debtor must not have a just cause or excuse

Continued on Page 100

Willful Deeds *cont'd*

for causing the injury. (The debtor wins if he was acting lawfully or morally and unwittingly caused the injury.)

These matters must be kept in mind by the parties during the pre-bankruptcy litigation proceedings. If a plaintiff is able to establish the elements of "willful and malicious" in state court proceedings, they will probably be given *res judicata* effect by the bankruptcy court.[6] This will greatly reduce the plaintiff's burden in an ensuing dischargeability case.

[1]11 U.S.C. 523(a)(6) provides: "A discharge under section 727 ... of this title does not discharge an individual debtor from any debt for willful and malicious injury by the debtor to another entity or the property of an other entity...."

[2]The §523(a)(6) exception to discharge does not apply in Chapter 13 cases. The creditor's strategy if the debtor files a Chapter 13 case is attempt to convert or dismiss the case based upon the debtor's bad faith.

[3]There is a disagreement among the Circuits over these meanings of "willful." In Kawaauhau v. Geiger, U.S. (1998) the Supreme Court recently adopted the "intent to injure" standard. See "Supreme Court Defines Willful Injury" elsewhere in this newsletter.

[4]The Kawaauhau decision probably does not change the meaning of "malicious."

[5]Alta was unable to borrow money in her own name.

[6]If Mr. Cecchini had negotiated language in the stipulated judgment that acknowledged liability as the result of an honest misunderstanding, the result may have been different.

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